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REPORT BY THE U.S.

General Accounting Office

Return On U.S. Investment In The Panama Canal

The Panama Canal Commission computes the U.S. return on a minor and decreasing portion of what the United States has invested in the Canal. The Commission believes what it is doing is in accordance with the intent of the Congress.

GAO concludes that there is a need to amend the Panama Canal Act of 1979 to provide for (1) computing the return on the total investment, (2) paying the return to the benefit of the United States, (3) preventing further erosion of the investment, and (4) recovering amounts that should have been paid in prior years.



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GAO/ID-83-36
MARCH 22, 1983

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

B-204078

The Honorable William Carney
Ranking Minority Member
Subcommittee on Panama Canal and
Outer Continental Shelf
Committee on Merchant Marines and Fisheries
House of Representatives

Dear Mr. Carney:

Subject: Return on U.S. Investment In the
Panama Canal (GAO/ID-83-36)

Your request letter states that you have offered an amendment to the Panama Canal Act of 1979 (22 U.S.C. 3601-3871 (Supp. IV 1980)) that would assure that (1) the United States would receive a return on its total investment in the Canal enterprise and (2) the return would be paid into miscellaneous receipts of the Treasury for the benefit of the U.S. Taxpayer. You noted from our report dated November 22, 1982 (GAO/ID-83-14) that we were pursuing this same matter and requested a report on our followup.

We have continued our inquiry into the way the Panama Canal Commission determines return on the U.S. investment. We concluded that the Panama Canal Act is unclear and needs to be changed to provide for (1) computing the return on the total U.S. investment, (2) paying this return to the benefit of the United States, (3) preventing further erosion of the investment, and (4) recovering amounts that should have been paid in prior years. The amendment you have proposed accomplishes all of these objectives except the last one. For your consideration, legislative language which would accomplish this objective is on page 8 of appendix I, which is a more detailed discussion of what the act requires, the Commission's position, and our analysis and conclusion. The Commission's formal comments are in appendix II.

We are sending copies of this report to the Administrator of the Panama Canal Commission; Director, Office of Management and Budget; and Secretaries of State, Defense, and the Army.

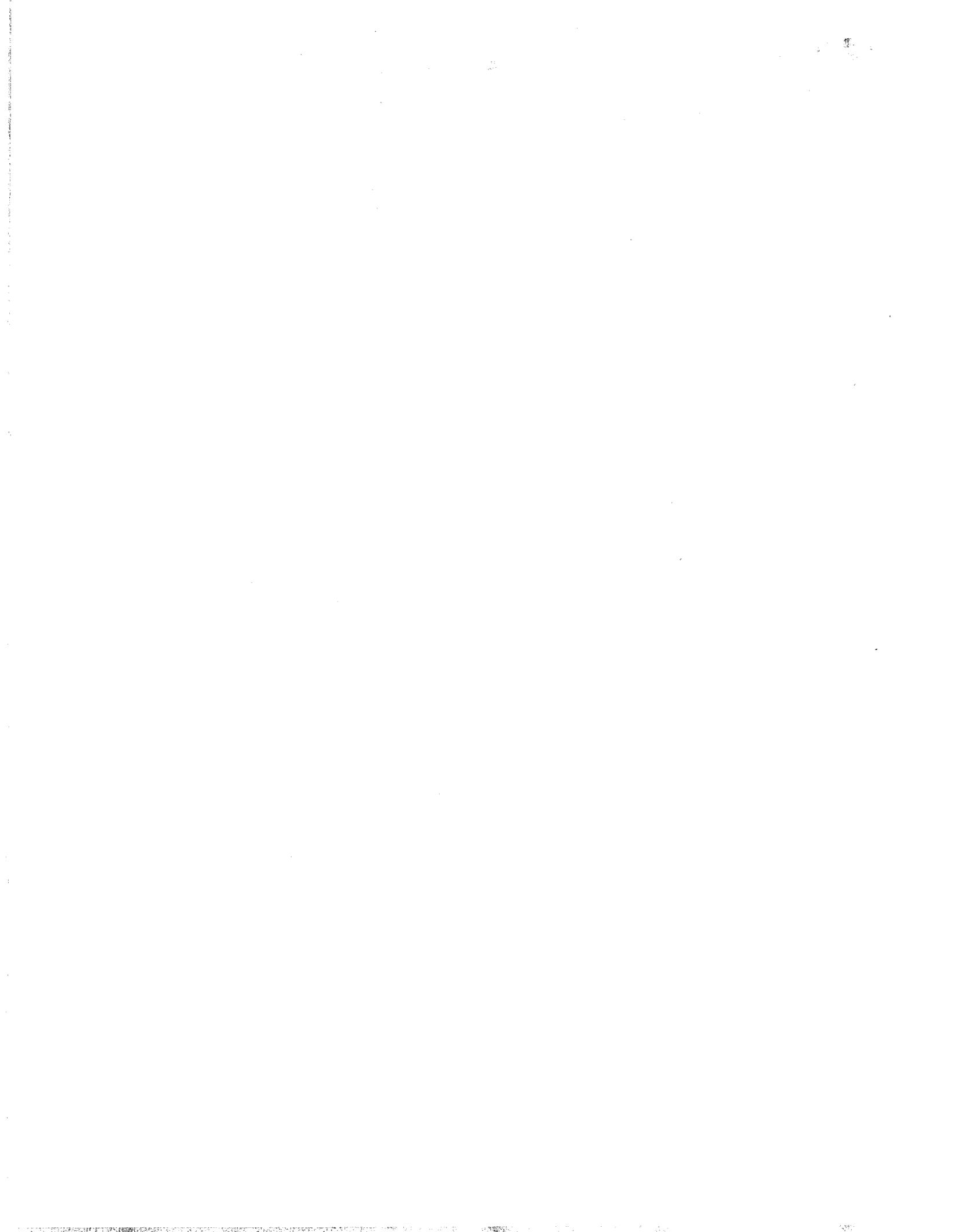
Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan".

Frank C. Conahan
Director

Enclosure

(487079)



RETURN ON U.S. INVESTMENT IN THE PANAMA CANALINTRODUCTION

Section 1603 (22 U.S.C. 3793) of the Panama Canal Act of 1979 provides for the United States to receive a return on its investment in the Panama Canal. In accordance with the Act, this return is calculated as an interest cost in the accounts of the Panama Canal Commission, a U.S. agency supervised by a board of five Americans and four Panamanians.

The Commission presently computes the U.S. return on a minor and decreasing portion of what the United States has invested in the Canal. However, to date, the United States has received no return on the millions of dollars it has invested. This is due to the way the Commission operates under the Act, which the Commission maintains is being properly interpreted and applied to comport with the intent of the Congress.

We conclude that, based on how the Commission presently interprets the Act, a decreasing portion of the U.S. investment is being used to compute the return. In our opinion, the Act is not clear on how this U.S. investment is to be computed, but the Commission's interpretation results in:

- The interest-bearing investment account being reduced by the dollar amount of property transfers, even when the amount had previously been included in a non-interest-bearing account.
- The investment accounts maintained by the Commission being reduced by the amount of return computed, resulting in an erosion of the investment on which future return amounts are to be computed.

Components of this issue were raised in our reports on the Commission's financial statements for fiscal years 1980 (ID-81-49) and 1981 (GAO/ID-83-14). To resolve this issue, we believe the Act should be amended to (1) provide for computing the return on the total U.S. investment, (2) provide for paying this return to the benefit of the United States, (3) prevent further erosion of the investment, and (4) provide for recovering amounts that should have been paid in prior years. The amendments we propose will increase the Commission's operating costs, which may require an increase in Canal toll rates to pay the increased amounts due each year and to recover and pay amounts due the United States in prior years.

RETURN ON INVESTMENT

Both the Republic of Panama and the United States have made significant investments in the Panama Canal. In recognition of

this fact, the Act provides for computing and paying to the Republic of Panama a return on its investment. It also provides for computing (but not paying) a return on the U.S. investment.

The Republic of Panama has contributed its resources--land, labor, water, and location--to the Canal. During the 3-year period ended September 30, 1982, the Commission paid the Republic of Panama about \$236 million as a return on that country's investment.

The U.S. investment in the Canal is the sum of (1) funds committed, but not yet expended, (2) unrecovered construction costs, (3) net income from operations, and (4) certain extraordinary expenditures. The investment is also the difference between the value of the assets (property, plant, equipment, and funds) and the amount of liability (amount owed to others) created to construct and operate the Canal. (The abbreviated balance sheet on p. 10 illustrates the relationship.) For the 3-year period ended September 30, 1982, the Commission has computed a return on the U.S. investment of \$32.3 million. The total investment was \$546.2 million at the start of this period and \$472.4 million at its end.

WHAT THE ACT REQUIRES

Section 1603 of the Act provides that "interest shall be computed, at a rate determined by the Secretary of the Treasury, on the investment of the United States in the Panama Canal as shown in the accounts of the Panama Canal Company at the close of business on the day preceding the effective date of this Act, and as adjusted in accordance with [this Act]."

With regard to adjusting the investment, the act provides that the investment will be increased by the expenditure from appropriations and value of property transferred to the Commission. The investment is to be decreased by the funds deposited into the Panama Canal Commission Fund in the Treasury and the value of property transferred to other agencies of the United States and to the Republic of Panama.

HOW THE ACT WAS APPLIED

The accounts of the Panama Canal Company on September 30, 1979, the day preceding the effective date of the Act, showed that the U.S. investment in the Canal stood at \$546.2 million. (See p. 11.) The Company had divided this investment into interest-bearing and non-interest-bearing segments. The Company was expected to pay a return on the interest-bearing investment,

(retained earnings) and extraordinary expenditures made for national policy reasons. On September 30, 1979, the U.S. investment in the Canal included \$226.9 million that was considered non-interest-bearing. Of this amount, \$194.3 million was retained earnings which had been reinvested in the Canal and \$11.8 million was the book value of the Thatcher Ferry Bridge, which had been built in response to a directive based on national policy. Even though the Company was not expected to pay interest on this amount, the Company clearly included the Bridge as part of the U.S. investment in the Panama Canal.

When the Act became effective, all assets and liabilities of the Panama Canal Company and the Canal Zone Government were transferred to the United States. Simultaneously, the Company and the Canal Zone Government ceased to exist. Their assets and liabilities were then distributed to other agencies of the United States--primarily the Department of Defense and the newly created Panama Canal Commission--and to the Republic of Panama. The Commission established the amount of the U.S. investment in the Panama Canal by calculating the Panama Canal Company's ending balances and recording the \$131.7 million in property that was being transferred to other U.S. agencies and to the Republic of Panama. The Commission continued the Company's practice of dividing the investment into interest-bearing and non-interest-bearing segments. Because the Act states that a transfer in assets will decrease the investment on which the return is computed (see p. 3), the Commission reduced that portion of the investment it had designated as interest-bearing by \$131.7 million. (See p. 11.)

COMMISSION POSITION

Although the Act does not specifically mention the terms "interest-bearing" and "non-interest-bearing," the Commission says the Act's legislative history is clear and that its intent is to continue the practice of the Panama Canal Company, which was established by the Canal Zone Code. Senate Reservation 6, which was incorporated in the Resolution of Ratification of the Treaty,^{1/} is cited to explain this position. It says in part that:

"After the date of entry into force of the Treaty, the Panama Canal Commission shall, unless otherwise provided by legislation enacted by the Congress of the United States of America, be obligated to reimburse the Treasury of the United States of America, as nearly as possible, for the interest cost of the funds or other assets directly invested in the Commission by the Government of the United States of America and for

^{1/}The Panama Canal Treaty of 1977; the Panama Canal Act of 1979 implements this Treaty.

the interest cost of the funds or other assets directly invested in the predecessor Panama Canal Company by the Government of the United States and not reimbursed before the date of entry into force of the Treaty. * * * For purposes of this reservation, the phrase 'funds or other assets directly invested' shall have the same meaning as the phrase 'net direct investment' has under section 62 of title 2 of the Canal Zone Code."

In House Report 96-98, the following comments are made,

"Section 413. Calculation of Interest.--This section defines the basis for computation of interest to be included in the formula for tolls rates in section 412(b), and to be shown in the accounts of the Commission under section 234. In general, the base on which interest is calculated will be the same as that established by present law for Panama Canal Company (2 CZ Code 62), that is the investment of the United States in the Panama Canal as reduced by payments into the Treasury and increased by new appropriations."

In addition, the House Senate conference report of September 24, 1978, contained the following comments.

"Interest Rate - (Section 1602)

"Section 202 of the Senate amendment provided that the rate of interest to be paid by the Panama Canal Commission to the Treasury on the net direct interest-bearing investment of the United States in the canal enterprise should be determined by the Secretary of the Treasury.

"The conferees adopted the House provision on interest but with the Senate language allowing the Secretary of the Treasury to determine the rate. It is the intention of the conferees that the Commission should continue to pay interest at the 'coupon' rate, the rate paid by the Panama Canal Company before October 1, 1979."

ANALYSIS

The Commission disagrees that the return should be paid on the entire investment and believes that only a portion of this investment should be considered when computing the return. The Commission, as previously mentioned, cites Senate Reservation 6 and the House and the House-Senate Conference reports as expressions of congressional intent.

In our view, both the Act and its legislative history do not clarify how to determine the U.S. investment on which return is computed. The Act addresses the matter of return on the

investment but does not use the terms "net direct investment," "interest-bearing," or "non-interest-bearing." Although the Commission says such terms were discussed and used during the congressional debate, we emphasize that they were not incorporated into the act.

Also, the Commission's decision to follow the Company's practice causes results that may be contrary to what might be expected. For example, the \$11.8 million book value of the Thatcher Ferry Bridge was included by the Panama Canal Company as part of the non-interest-bearing investment because it had been constructed to meet "national policy" rather than the needs of the Panama Canal. The bridge was transferred to the Republic of Panama on October 1, 1979. The transfer did not reduce the non-interest-bearing investment account because the formula for adjusting the U.S. investment, as provided in the Act, requires all transfers of property to reduce the base on which the return is to be computed.

We use the bridge transaction to illustrate this result, because the bridge is linked with the non-interest-bearing investment account that appeared in the Company's accounts. We do not know what other property was purchased with the remaining \$215.1 million in that account. Therefore, it is not known whether additional property acquired with a non-interest-bearing investment was transferred to other U.S. agencies or to the Republic of Panama. We do know that all transfers served to reduce the interest-bearing amount, a situation caused by the Commission's decision to follow the previous practice of the Company.

RETURN REDUCES THE INVESTMENT BASE

The \$32.3 million computed as a return on the U.S. investment in the Panama Canal has not been paid to the United States. This is because the Act simply makes no provision for the United States to receive payment of the return.

The Act requires that the return on the U.S. investment be recognized as an operating cost. The return on the Republic of Panama's investment is treated this way as well. Therefore, an amount attributable to the return is collected when Canal users pay tolls. All tolls and other receipts of the Commission are deposited into the Panama Canal Commission Fund in the U.S. Treasury. However, there is no reason for the Commission to request that the Congress authorize or appropriate the amount representing the return on investment from the fund because there is no provision in the Act for paying this return. Because Section 1603 of the Act requires the investment of the United States to be decreased for amounts paid into the fund, the amount representing the return reduces the base on how this return is to be computed in future years.

The Commission is aware of this result. The matter was addressed in an exchange of letters with the Chairman, House Committee on Merchant Marine and Fisheries, prior to passage of the Act. The Senate was also informed by letter dated May 10, 1979, to the Chairman, Subcommittee on Transportation and Related Agencies, Senate Committee on Appropriations. This letter states:

"[The return] * * * comprises a portion of the total tolls revenue deposited into Treasury. The result is that * * *[these] * * * deposits serve to reduce the investment base to which future rates are applied."

CONCLUSION

As mentioned, the Commission computes the legally mandated return on the U.S. investment on only a minor portion of the investment rather than on the total investment. The amount thus computed (by operation of the Act), \$32.3 million for the 3 years ended September 30, 1982, is not paid to the benefit of the United States and serves to reduce the base on which future return amounts are to be computed. The Commission considers this to be in accordance with the Act and the expressed and implied intent of the Congress.

It is not clear whether the Act intends to continue the practice of the Panama Canal Company, which segregates the U.S. investment into interest-bearing and non-interest-bearing portions. This practice results in the situation described above, causing some unexpected transactions. In addition, the Commission's interpretation means that the return on the U.S. investment does not compare to the return on the Republic of Panama's investment.

We believe that the United States should receive a return on its total investment in the Canal. Changes in the Act's language designed to produce this effect are required. In the event, however, that it is decided to uphold the current practice of the Commission, a need still exists to prevent the further erosion of the interest-bearing investment of the U.S. amount and to adjust it to reflect underaccrual of prior interest earnings. A retroactive adjustment and a provision for payment of interest into "Miscellaneous Receipts" of the U.S. Treasury would accomplish the latter purpose.

Last year, the following amendment to the Act was introduced (see citation on p. 3 for comparison).

"Sec. 1603(a) For purposes of section 1311 and 1602 of this Act, interest shall be computed, at a rate determined by the Secretary of the Treasury, on the entire investment of the United States in the Panama Canal as shown in the

accounts of the Panama Canal Company at the close of business on the day preceding the effective date of this Act, and as adjusted in accordance with subsections (b) and (c) of this section. Interest as so computed shall be paid into the Treasury as miscellaneous receipts."

This proposed amendment accomplishes all that we conclude is necessary except recovery of amounts due from prior years. This could be done by adding the following language.

"The amount paid into the Treasury as miscellaneous receipts shall include interest accrued from the effective date of this Act, as computed on the total investment of the United States."

The proposal (1) requires that the return be computed on the total U.S. investment, (2) provides the Commission with authority to pay the return to the benefit of the United States, and (3) prevents the amount of return from reducing the base on which it is computed.

The suggested addition provides that payment of interest on the U.S. total investment is retroactive to October 1, 1979, including interest on those assets the Commission does not now include in its interest computation. We estimate this amount to be about \$114.4 million as of September 30, 1982.

AGENCY COMMENTS

The Commission, in a letter dated February 2, 1983, provided comments on a draft of this report. (See app. II) The Commission continues to maintain that it has correctly interpreted the intent of the Congress. Below is our response to the Commission's letter.

We state that the terms "net direct investment," "interest-bearing," and "non-interest-bearing" were models that were available to the drafters of the Act. For unknown reasons, the Congress chose not to use any of these terms, each of which defined a specific portion of the U.S. investment in the Panama Canal Company. Instead, the Act states that the return is to be computed "* * * on the investment of the United States in the Panama Canal * * *"^(our emphasis). The investment of the United States is a larger amount than the amounts defined by such terms as "net direct investment," "interest-bearing investment," or "non-interest-bearing investment."

We agree that the Act's legislative history provides some support for the Commission's interpretation. We also point out the pertinent sections of title 2, Canal Zone Code, which support or explain the Commission's position. Also, we note that Section 3303(a)(I) of the Act specifically repealed title 2 of the Canal Zone Code.

The Commission further concludes that we say that the Commission's interpretation of the legislation, rather than the actual legislative language, causes the erosion of the investment base. We agree that the language of the Act causes the erosion and we so state in this report.

The Commission also suggests that the report should recognize that the majority of the non-interest-bearing investment of the predecessor Panama Canal Company was in the form of retained earnings. Also, the Commission says that it should not be made to pay interest on retained earnings because this would be unfair to the shipping industry. The composition of the non-interest-bearing account of the Panama Canal Company as of September 30, 1979, is set forth in our report. Money can be appropriated to the Canal organization and invested in Canal improvements or money from earnings can be retained and then invested in Canal improvements. Improvements acquired under either method enhance Canal operations, and it is proper to expect a return on any such investment. Further, as pointed out in this report, we do not know whether the improvements acquired with these retained earnings were transferred to other U.S. agencies, transferred to the Republic of Panama, or are presently in use by the Commission.

The Commission's comments raise a question about our continued evaluation of approved principles and standards and the way these have been implemented by an executive agency, which we think is a proper and continuing GAO operating procedure. In this particular case, the Commission was aware that GAO had questions about how the return on the U.S. investment was being computed.

In our report on fiscal year 1980, a question was raised about how the return was determined and treated. (See ID-81-49.) In our report for fiscal year 1981, we took further steps and qualified our opinion on the Commission's financial statements because of an uncertainty about how the Commission was computing the return on the U.S. investment. (See GAO/ID-83-14.) During this time, we have considered the requirements of the Act, the Act's legislative history, the Commission's position, and the State Department's position on this issue. The conclusions stated earlier are the results of this study.

PANAMA CANAL COMMISSION
BALANCE SHEET

	As of September 30		
	1980	1981	1982
	(note b)		(note a)
	(millions)		
<u>ASSETS</u>			
Property, Plant, and Equipment	\$459.2	\$466.3	\$466.5
Current Assets	174.5	181.3	153.4
Other Assets	<u>14.7</u>	<u>14.4</u>	<u>12.8</u>
Total Assets	\$648.4	\$662.0	\$632.7
<u>LIABILITIES</u>			
Current Liabilities	139.2	151.4	139.6
Long-term Liabilities and Reserves	<u>27.4</u>	<u>38.2</u>	<u>38.7</u>
Total Liabilities	\$166.6	\$189.6	\$178.3
<u>INVESTMENT OF THE UNITED STATES</u>			
Invested Capital	384.8	377.5	348.3
Funds Committed	<u>97.1</u>	<u>94.9</u>	<u>106.1</u>
Total Investment (note c)	<u>\$481.9</u>	<u>\$472.4</u>	<u>\$454.4</u>

a Per tentative statements dated 12/23/82 (rounded).

b Error due to rounding.

c Total Investment equals total assets minus total liabilities.

INVESTMENT OF THE UNITED STATES
IN THE PANAMA CANAL

	Panama Canal Company <u>9/30/79</u>	Panama Canal Commission <u>10-1-79</u>	<u>As of September 30--</u>		
			<u>1980</u>	<u>1981</u>	<u>1982</u>
					(note a)
	(millions)				
Interest-bearing	\$319.3	\$187.6	\$148.2	\$128.4	\$ 89.8
Non-interest-bearing	<u>226.9</u>	<u>266.9</u>	<u>236.5</u>	<u>249.1</u>	<u>258.5</u>
Total Invested Capital	\$546.2	\$414.5	\$384.7	\$377.5	\$348.3
 <u>COMMITTED FUNDS</u>					
Operating funds	-	-	76.9	59.4	74.6
Capital funds	-	-	20.2	25.5	21.5
Emergency funds	<u>-</u>	<u>-</u>	<u>-</u>	<u>10.0</u>	<u>10.0</u>
Total Committed Funds	-	-	\$ 97.1	\$ 94.9	\$106.1
 <u>TOTAL INVESTMENT OF</u> <u>THE UNITED STATES</u>					
	<u>\$546.2</u>	<u>\$414.5</u>	<u>b\$481.9</u>	<u>\$472.4</u>	<u>\$454.4</u>

a Per tentative statements dated 12/23/82 (rounded)

b Error due to rounding



PANAMA CANAL COMMISSION

OFFICE OF THE ADMINISTRATOR

BALBOA
REPUBLIC OF PANAMA

U.S. MAILING ADDRESS
APO MIAMI 34011

FEB 2 1983

Mr. Thomas R. Brogan, Director
Latin America Branch
International Division
U.S. General Accounting Office
c/o American Embassy
Box E
APO Miami 34002

Dear Mr. Brogan:

We have reviewed the GAO draft report entitled "Return On The Investment Of The United States In The Panama Canal" dated January 18, 1983. The following comments address certain aspects of the draft report:

Please refer to pages 5 and 6 of the draft report which discuss the Commission's position on whether interest is computed on the total investment or on the net direct investment. The full text of the Commission's position, submitted to the Director of OMB on January 14, 1983, is germane to this issue. It is requested that the full text of this position be available to all report addressees. The Commission, therefore, requests that the letter to the Director of OMB (copy enclosed) together with the comments herein be included as an attachment to the final report. *

Further, it should be pointed out that on page 6 of the draft report, GAO implies that the Canal organization considered the terms "net direct investment, interest-bearing and non-interest-bearing" as models used during debate of the Panama Canal Act of 1979. This is not true. Conference report 96-473 specifies that interest shall be calculated on the net direct interest-bearing-investment. As pointed out in the enclosed letter, the conferees adopted the provision of House Report 96-98 which defined the investment base as being the same as that established by 2 Canal Zone Code 62, i.e., interest-bearing and non-interest-bearing. Conference reports have been recognized by the Comptroller General as the most authoritative single source of legislative history (B-142011, April 30, 1971). Thus, the Commission believes the legislative history contains a clear statement of Congressional intent and that phrases used on page 6 of the draft report are much more than "models" as implied.

Mr. Thomas R. Brogan, Director

FEB 2 1982

In summary, the Commission established the investment base in compliance with Section 1603 of the Act recognizing the intent of Congress specified in the legislative history of the Act and Reservation 6 to the Treaty. GAO's draft report could have recognized more clearly the intent of Congress as evidenced in the legislative history of the Act and could have recognized all provisions of 2 Canal Zone Code 62 which define the term net direct investment.

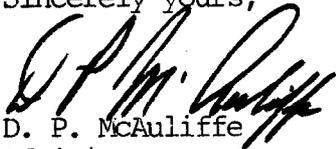
Please note that page 8 of the draft report gives a fair presentation of actions taken by Canal officials in advising Congress of the impact on the investment base that would result from the treatment of interest as proposed in the draft legislation. However, on page 1 of the draft report, GAO states that the Commission's interpretation rather than operation of the Act causes the erosion of the investment base. This inaccuracy should be corrected.

In the interest of objective reporting, it should be recognized that the majority of the non-interest-bearing investment of the predecessor Panama Canal Company was retained earnings -- the cumulative net profit from 1952 - 1979 which was reinvested in the Canal during those years. To require the Commission to pay interest on this amount would result in Canal users, i.e., the shipping industry, paying interest on the Company's net profits which were generated from tolls and other charges paid by shipping in the first place.

In addition to the points discussed above, it should be noted that on September 14, 1982, the Comptroller General of the United States approved the Accounting Principles and Standards Statement of the Panama Canal Commission (GAO/AFMD-82-118). The letter of approval stated that the "Statement is adequate and in conformance with the accounting principles and standards prescribed by our Office." Since the Statement recognized the interest-bearing and non-interest-bearing elements of the net direct investment, it is unclear why GAO takes a contradictory view in the draft of this report.

The Commission appreciates having had the opportunity to review and comment on the draft report.

Sincerely yours,


D. P. McAuliffe
Administrator

Enclosure

*GAO Note: Page numbers in this letter refer to our draft report.



PANAMA CANAL COMMISSION

OFFICE OF THE ADMINISTRATOR

BALBOA
REPUBLIC OF PANAMA

U.S. MAILING ADDRESS
APO MIAMI 34011

JAN 14 1983

Honorable David A. Stockman
Director, Office of Management and Budget
Executive Office of the President
Washington, D.C. 20503

Dear Mr. Stockman:

The GAO report to the Congress entitled "Examination Of Financial Statements Of The Panama Canal Commission For The Years Ended September 30, 1981 and 1980" (GAO/ID-83-14 dated November 22, 1982) has been carefully reviewed. The report contains an audit opinion which is qualified because of an uncertainty asserted by GAO concerning the investment of the U.S. on which interest is calculated and paid. In compliance with paragraph 8b(3)(b) of OMB Circular A-50 Revised September 29, 1982, the following comments address the qualified opinion.

On pages 1 and 2 of the report, GAO states that the "***Commission chose to compute interest on only a portion of the U.S. investment, a decision which reduces interest costs." GAO further states that the "***Commission's decision to compute interest on only a portion of the U.S. investment is consistent with its predecessor agencies' (The Panama Canal Company and Canal Zone Government) practice of segregating (sic) the U.S. investment in the Canal into interest-bearing and noninterest-bearing amounts. We (GAO) are not certain that the United States contemplated continuation of that practice when the Panama Canal Act of 1979 was passed." On the basis of that uncertainty, GAO qualified its opinion.

The Commission believes that it has correctly interpreted the law and applied it in a manner that comports with the intent of the Congress. The comments set forth below address whether interest is computed on the total investment of the United States in the Panama Canal or on the net direct investment. The comments are essentially the same as written comments provided to GAO in response to the draft report of our fiscal year 1981 financial statements.

JAN 14 1983

Honorable David A. Stockman

Investment of the United States. Section 1603(a) of the Panama Canal Act of 1979 (the Act) provides that:

interest shall be computed *** on the investment of the United States in the Panama Canal as shown in the accounts of the Panama Canal Company at the close of business on the day preceding the effective date of this Act,."

While the Act does not specifically mention interest and non-interest-bearing investment, the legislative history is quite clear in the intent to continue the net direct investment principle established by Section 62, Title 2 of the Canal Zone Code. In House Report No. 96-98 issued by the Committee on Merchant Marine and Fisheries of the House of Representatives to accompany H.R. 111, which became the Act, the following comments are made on page 73 of the sectional analysis.

"Section 413. Calculation of interest. -- This section defines the basis for computation of interest to be included in the formula for tolls rates in section 412(b), and to be shown in the accounts of the Commission under section 234. In general, the base on which interest is calculated will be the same as that established by present law for the Panama Canal Company (2 CZ Code 62), that is the investment of the United States in the Panama Canal as reduced by payments into the Treasury and increased by new appropriations."

Section 413 of H.R. 111 and Section 1603 of the Act are basically the same as they refer to the beginning investment in the Panama Canal. It shall be the amount shown in the Company's accounts on the day preceding the effective date of the Act. In the final conferences there were some changes in this section concerning the rate of interest to be charged but no rejection of the concept of the investment base. The conference report of September 24, 1979 (Report 96-473) had the following comments on page 62:

"Interest Rate - (Section 1602).

Section 202 of the Senate amendment provided that the rate of interest to be paid by the Panama Canal Commission to the Treasury on the net direct interest-bearing investment of the United States in the canal enterprise should be determined by the Secretary of the Treasury. Section 413(d) of the House bill repeated the requirement that interest be paid, but stipulated that it should be calculated at the 'average market yield' rate. (Underscoring supplied.)

JAN 1 1983

Honorable David A. Stockman

"The conferees adopted the House provision on interest but with the Senate language allowing the Secretary of the Treasury to determine the rate. It is the intention of the conferees that the Commission should continue to pay interest at the 'coupon' rate, the rate paid by the Panama Canal Company before October 1, 1979.

"The conferees also modified the language of this section (new Sec. 1603(b)(2)(B) and (C)) to make it clear that those subsections cover non-capital as well as capital assets."

The cited conference report makes no mention of an intent to change the definition of the base on which interest is computed. If such had been intended, we believe there would have been a clear statement to that effect. Thus, the interpretation of the interest base as contained in the House Report No. 96-98 stands as the intent of Congress.

Further definition and interpretation of the investment base can be obtained from Senate Reservation 6, incorporated in the Resolution of Ratification of the Treaty. Reservation 6 states, in part, that:

"For purposes of this reservation, the phrase 'funds or other assets directly invested' shall have the same meaning as the phrase 'net direct investment' has under section 62 of title 2 of the Canal Zone Code."

Section 62 of Title 2 of the Canal Zone Code specifically provided for interest-bearing and non-interest-bearing elements of the United States investment in the Panama Canal Company.

In summary, the Commission established the investment base in compliance with Section 1603 of the Act recognizing the intent of Congress specified in the legislative history of the Act and Reservation 6 to the Treaty. GAO's report could have recognized the intent of Congress as evidenced in the legislative history of the Act and could have recognized all provisions of 2 Canal Zone Code 62 which define the term net direct investment.

Finally and in the interest of objective reporting, it should be recognized that the majority of the non-interest-bearing investment of the predecessor Panama Canal Company was retained earnings -- the cumulative net profit from 1952 - 1979 which was reinvested in the Canal during those years. To require the Commission to pay interest on this amount would result in Canal users, i.e., the shipping industry, paying interest on the Company's net profits which were generated from tolls and other charges paid by shipping in the first place.

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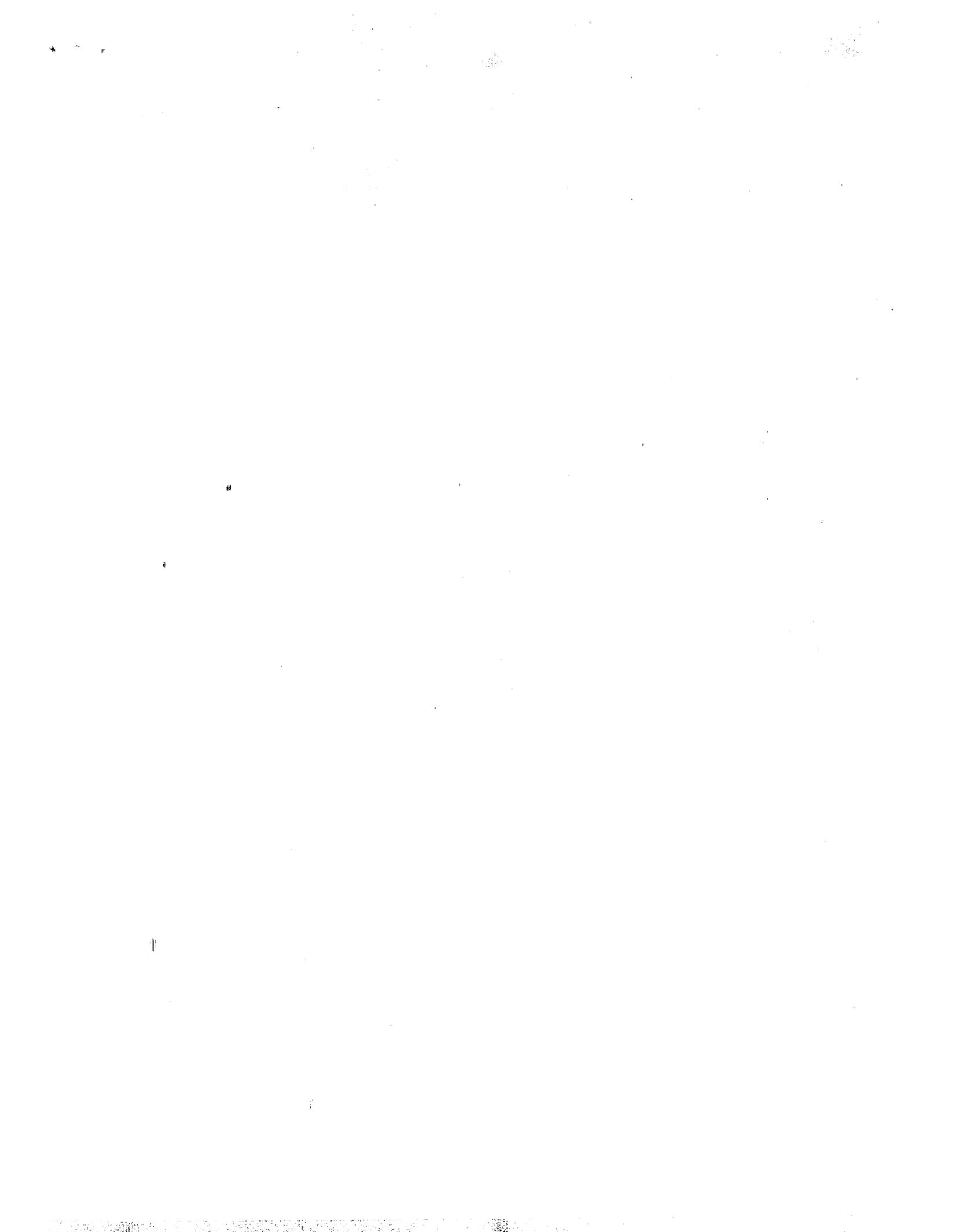
Honorable David A. Stockman

In addition to the points discussed above, it should be noted that on September 14, 1982, the Comptroller General of the United States approved the Accounting Principles and Standards Statement of the Panama Canal Commission (GAO/AFMD-82-118). The letter of approval stated that the "***Statement is adequate and in conformance with the accounting principles and standards prescribed by our Office." Since the Statement recognized the interest-bearing and non-interest-bearing elements of the net direct investment, it is unclear why GAO took an opposite view in qualifying the opinion on our financial statements.

Sincerely yours,

Original Signed

D. P. McAuliffe
Administrator



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